STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
DONALD C. BARNUM, JR.	:	DETERMINATION DTA NO. 821705
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Years 2000 through 2002.	:	

Petitioner, Donald C. Barnum, Jr., filed a petition for redetermination of a deficiency or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the New York City Administrative Code for the years 2000 through 2002.

A hearing was held before Frank W. Barrie, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on February 7, 2008 at 10:30 A.M., with all briefs to be submitted by August 22, 2008, which date began the six-month period for the issuance of this determination. Petitioner appeared by David J. Silverman, EA. The Division of Taxation appeared by Daniel Smirlock, Esq. (Peter B. Ostwald, Esq., of counsel).

ISSUES

I. Whether petitioner had a voluntary disclosure agreement with the Division of Taxation concerning the later years of 2003 through 2005, which prohibited assessments for the earlier years at issue in this matter.

II. Whether there was a rational basis for the notices of deficiency issued by the Division of Taxation based upon information received from the Internal Revenue Service.

III. Whether petitioner has substantiated his income received and business expenses incurred in the pursuit of his career as a musician.

IV. Whether penalties should be abated.

V. Whether the notices of deficiency, statements of proposed audit changes, a certification of a search for petitioner's tax returns, and the auditor's affidavit were improperly admitted into evidence since no witness was presented by the Division of Taxation to provide a foundation for these documents.

VI. Whether the auditor's affidavit should be given no weight because it was not specifically itemized on the hearing memorandum submitted by the Division prior to the hearing.

FINDINGS OF FACT

1. Petitioner, a talented musician, earned wages from three employers during each of the years at issue: as a singer in the chorus of the Metropolitan Opera, as the minister of music at a Roman Catholic church in Brooklyn Heights, and as a singer in a Jewish choir of a Manhattan synagogue. In addition, petitioner earned income for his musical abilities as a chorus master for the Schola Hebraica funded by the Milken Foundation, as the director of the professional chorus used by the Opera Orchestra of New York, which presented three concert version of operas at Carnegie Hall each year, and as the provider of classical music for large church weddings. The income petitioner received from these additional activities involved more complicated accounting than merely reporting wage income, since petitioner acted, in his words, as a "subcontractor." For example, in 2002 petitioner received a stipend from the Milken Foundation to support performances by the Schola Hebraica, which petitioner, in turn, would pay out to the

other members of the chorus, retaining only a small portion of the stipend as his own compensation. Similarly, when petitioner was hired to provide music at a big church wedding, he would have to pay out of his fee the orchestral musicians he would hire for the occasion.

2. In the fall of 2001, petitioner became overwhelmed with the loss of a loved one, and admits that he failed to timely prepare and file his federal and state income tax returns. In fact, it was not until the hearing in this matter that petitioner provided completed New York State and City personal income tax returns for the years at issue. Petitioner's federal income tax returns for 2000 and 2001 were filed on November 21, 2003, while his 2002 federal income tax return was dated August 19, 2005 and presumably filed soon thereafter. A review of petitioner's federal income tax return for 2000 shows that petitioner failed to properly report his nonwage earnings from his musical activities on a Schedule C. Rather he reported such income as "other income," and on a Schedule A, deducted substantial "other expenses" of $76,688.67 to account for the expenses he incurred in conducting such activities, as detailed in Finding of Fact 1. Petitioner's federal income tax returns for 2001 and 2002 properly reported such income on a Schedule C, Profit or Loss from Business. Utilizing the information on petitioner's federal returns, petitioner's representative, who is a professional preparer of tax returns, computed New York State and City tax due of $1,351.00 for 2000, a refund of $11.00 for 2001 and tax due of $3,236.00 for 2002 on the New York tax returns he prepared and presented at the hearing. In calculating tax due of $1,351.00 for 2000, petitioner reported New York State tax of $2,324.00 and New York City resident tax of $1,337.00 for a total 2000 tax liability of $3,661.00. He then subtracted tax withheld of $2,315.00 to calculate tax due of $1,351.00 for 2000. This calculation was done incorrectly since the amount of tax due should be $1,346.00: $3,661.00 less $2,315.00 equals $1,346.00. In calculating a refund of $11.00 for 2001, petitioner reported New York State

tax of $1,365.00 and New York City resident tax of $770.00 for a total 2001 tax liability of $2,135.00. He then subtracted tax withheld of $2,146.00 to calculate a refund of $11.00. In calculating tax due of $3,236.00 for 2002, petitioner reported New York State tax of $4,429.00 and New York City resident tax of $2,452.00 for a total 2002 tax liability of $6,881.00. He then subtracted tax withheld of $3,743.00 to calculate tax due of $3,236.00 for 2002. This calculation was also done incorrectly since the amount of tax due should be $3,138.00: $6,881.00 less $3,743.00 equals $3,138.00.

3. The Division of Taxation (Division) issued three statements of proposed audit changes, each dated January 8, 2007, against petitioner which asserted New York State and City income tax due for 2000 of $8,424.00 plus penalty[1] and interest, for 2001 of $13,043.00 plus penalty and interest, and for 2002 of $5,255.00 plus penalty and interest. Each statement explained that the Division had "previously sent letters advising you that we received information from the Internal Revenue Service regarding income you received and that you may have a New York State personal income tax filing responsibility." Petitioner was also informed that the Division did "not have a record of a New York State income tax return on file," and that petitioner "did not reply to our previous letters asking about your New York State return." As a result, the Division advised that it had computed tax due for each of the years at issue by using the information reported on petitioner's federal return, which the IRS had provided it, as well as other information provided by the IRS "such as Form 1099 information" as to petitioner's "wages, interest, dividends, capital gains, and other sources of income."

[1] Late filing penalty at 5% per month up to the allowable maximum of 25% per Tax Law § 685(a)(1) and negligence penalty of 5% as an addition to tax per Tax Law § 685(b)(1) were imposed.

4. For 2000, the Division allowed a standard deduction of $7,500.00, City of New York school credit of $45.00 and withholding tax of $2,315.00, and computed tax due of $8,424.00 as follows:

Federal adjusted gross income per federal information	$112,862.00
New York adjusted gross income	112,862.00
New York standard deduction for single tax status	(7,500.00)
New York taxable income	105,362.00
New York State income tax due	6,922.00
City of New York resident income tax due	3,862.00
Total New York State and City income tax	10,784.00
City of New York school tax credit	(45.00)
Total tax withheld	(2,315.00)
Tax due	$8,424.00

5. For 2001, the Division allowed a standard deduction of $7,500.00, City of New York school credit of $62.00, withholding tax of $1,795.00 and estimated tax payments of $500.00, and computed tax due of $13,043.00 as follows:

Federal adjusted gross income per federal information	$157,108.00
New York adjusted gross income	157,108.00
New York standard deduction for single tax status	(7,500.00)
New York taxable income	149,608.00
New York State income tax due	10,248.00
City of New York resident income tax due	5,152.00
Total New York State and City income tax due	15,400.00
City of New York school tax credit	(62.00)
Total tax withheld	(1,795.00)
Estimated tax payments	(500.00)
Tax due	$13,043.00

6. For 2002, the Division allowed a dependent exemption of $1,000.00, a standard deduction of $7,500.00, City of New York school credit of $62.00 and withholding tax of $2,615.00, and computed tax due of $5,255.00 as follows:

Federal adjusted gross income per federal information	$88,963.00
New York adjusted gross income	88,963.00

New York standard deduction for single tax status	(7,500.00)
Dependent exemption	(1,000.00)
New York taxable income	80,463.00
New York State income tax due	5,115.00
City of New York resident income tax due	2,817.00
Total New York State and City income tax	7,932.00
City of New York school tax credit	(62.00)
Total tax withheld	(2,615.00) [2]
Tax due	$5,255.00

7. The Division issued three notices of deficiency, each dated March 5, 2007, asserting New York State and City income tax due of $8,424.00 plus penalty and interest, $13,043.00 plus penalty and interest, and $5,255.00 plus penalty and interest for the years 2000, 2001 and 2002, respectively, in conformance with the statements of proposed audit changes dated January 8, 2007, as detailed in Findings of Fact 3 through 6.

8. Approximately three months before the Division issued the statements of proposed audit changes, petitioner's representative, David J. Silverman, sent a letter dated September 18, 2006, which was stamped "received" by the Division on September 25, 2006, requesting that an unnamed taxpayer be permitted "to take part in the State/City Voluntary Disclosure Program." He advised that "his client" will file his New York State and City personal income tax returns for 2003, 2004 and 2005, and that "No prior contact has been made regarding these returns by your

[2] During 2002, petitioner in fact had a total of $3,679.38 in State and City income taxes ($2,355.05 plus $1,324.33) withheld by his employers as follows:

Employer	State tax withheld	City tax withheld
Metropolitan Opera	$1,599.57	$ 919.38
St. Charles Borromeo Church	699.60	363.00
Trustees of the Congregation	55.88	41.95
Totals	$2,355.05	$1,324.33

department." However, the Division's case contact records disclose that by an "initial letter" dated September 11, 2006 (one week before the date of Mr. Silverman's letter), petitioner had been advised that he was "non-compliant" for the years at issue here of 2000 through 2002.

9. The Division by a letter dated December 6, 2006 over the signature of Nonie Manion, Director of Tax Audits, responded to Mr. Silverman's letter dated September 18, 2006, noting that it "would be willing to accept your proposal as a voluntary disclosure for [tax years 2003, 2004 and 2005]" subject to the following conditions and requirements: (1) your client must file resident income tax returns for 2003, 2004 and 2005; (2) your client must pay any tax and interest for these years; and (3) for tax year 2006, your client must make payment of estimated income tax on the next due date of January 16, 2007. In addition, the Division noted that it was "willing to accept your proposal as a voluntary disclosure" so long as your client "has neither been contacted nor audited for tax years 2003, 2004, and 2005, by the New York State Department of Taxation and Finance, the Internal Revenue Service, or any government agency with which the Department has an exchange agreement." If these conditions and requirements are met, the Division "agrees to" the following: (1) waive penalties, (2) limit the scope of its review to tax years 2003, 2004 and 2005 barring the existence of special or unusual circumstances, and (3) not refer the case for criminal investigation or prosecution. The Division also set due dates for the above conditions and requirements concerning the filing of tax returns and payment of tax and interest due: (1) tax returns must be received no later than 30 days after the date of this letter, i.e., by January 5, 2007; (2) payment of tax and interest due, or arrangement to pay such tax and interest, must be received "no later than 30 days after the receipt of the returns," i.e., by February 4, 2007. The Division also noted that "If we do not hear from you within the 30-day period [i.e., by January 5, 2007], this letter agreement will be null and

void." In addition, the Division reserved the right to audit the returns to be filed under the letter agreement.

10. As noted in Finding of Facts 4, 5 and 6, the starting point for the Division's computation of tax asserted due in each of the three statements of proposed audit changes dated January 8, 2007 was "Federal adjusted gross income per federal information," in the amounts of $112,862.00, $157,108.00 and $88,963.00 for 2000, 2001 and 2002, respectively. In contrast, petitioner's representative, who was enrolled in the Internal Revenue Service's electronic retrieval system, obtained copies of petitioner's IRS account transcripts on August 16, 2007 for 2000 and 2001, which show petitioner's federal adjusted gross income as $36,706.00 and $153,138.00 for 2000 and 2001, respectively, and petitioner's federal taxable income as $25,116.00 and $25,228.00 for 2000 and 2001, respectively. Petitioner's representative also obtained a copy of petitioner's IRS account transcript for 2002 on September 13, 2006, which shows petitioner's federal adjusted gross income as $94,090.00 and federal taxable income as $86,390.00.

11. The New York State and City income tax returns prepared by petitioner's representative and presented at the hearing, as noted in Finding of Fact 1, reported New York State and City personal income tax due based upon the amounts of federal adjusted gross income which had been reported and accepted by the Internal Revenue Service. In addition, petitioner's deductions were itemized on his returns while the Division, as noted in Findings of Fact 4 through 6, used the standard deduction in calculating tax asserted due. This itemization of deductions explains the much smaller amount of tax calculated due by petitioner, as noted in Finding of Fact 2.

SUMMARY OF THE PARTIES' POSITIONS

12. The Division contends that a presumption of correctness attaches to the Division's notices of deficiency and that petitioner failed "to carry his burden of proving by clear and convincing evidence that the statutory notices were erroneous or improper." Further, the Division emphasizes that petitioner failed to keep permanent books of account or records which were "sufficient to establish the amount of gross income, deductions, credits or other matters required to be shown" on his income tax returns.

13. Petitioner complains that the Division "did not allow the Petitioner to deduct his allowable business and miscellaneous itemized deduction[s] after the IRS received, processed, reviewed, and allowed these deductions when he filed his federal returns." In addition, petitioner maintains that the Division's program with the IRS to exchange information "failed to transmit . . . the Petitioner's updated information regarding these deductions when his federal returns were filed."

CONCLUSIONS OF LAW

A. The voluntary disclosure agreement, as detailed in Finding of Fact 8, concerning the years 2003 through 2005, does not prohibit the Division from asserting taxes due for the years 2000 through 2002, which are at issue in this proceeding. Under this agreement, the Division would "limit the scope of its review" to the later years of 2003 through 2005 "barring the existence of special . . . circumstances." As noted in Finding of Fact 8, by letter dated September 11, 2006 the Division had contacted petitioner concerning the years 2000 through 2002, which was one week earlier than the letter dated September 18, 2006 from petitioner's representative which sought a voluntary disclosure agreement for the years 2003 through 2005. The fact that the Division had already taken action with regard to the years at issue here, *prior to* any contact

from petitioner or his representative concerning the later years covered by the voluntary disclosure agreement, constitutes the existence of "special circumstances" which counteracts the limit on the scope of the Division's review to the later years of 2003 through 2005 only. Consequently, review of petitioner's New York State and City income tax liability for 2000 through 2002 is not barred by the voluntary disclosure agreement.

B. When the Division issues a notice of deficiency to a taxpayer, a presumption of correctness attaches to the notice, and the burden of proof is on the taxpayer to demonstrate that the deficiency assessment is erroneous by clear and convincing evidence (***Matter of O'Reilly***, Tax Appeals Tribunal, May 17, 2004). In addition, the Tax Appeals Tribunal has also noted that "the question to be asked in determining the validity of an assessment in the first instance is whether the assessment is rational, not whether it is correct" (***Matter of Bernstein***, Tax Appeals Tribunal, December 24, 1992). In the matter at hand, the Division's reliance on information obtained from the IRS, as detailed in Finding of Fact 3, meets the rational basis test, in the first instance, for the notices of deficiency at issue.

C. Turning to the issue of whether petitioner has demonstrated that the notices of deficiency were erroneous by clear and convincing evidence, it is noted that the Tax Appeals Tribunal has established the principle that credible testimony is sufficient as a matter of law, even without corroborating documentary evidence, to establish, for example, that a taxpayer did not spend more than 183 days in New York (***Matter of Avildsen***, Tax Appeals Tribunal, January 26, 1995). This matter, which concerns the amount of petitioner's income during the three years at issue as well as his entitlement to deductions for business expenses is also factual in nature. Here, petitioner offered his candid and credible testimony to establish his income and to support his deductions. He proved that the IRS accepted the amounts he reported as income and

expenses for the years at issue, and that his itemization of deductions, as opposed to the Division's use of a standard deduction, was proper. Furthermore, on cross-examination, petitioner's credibility was *never undermined* in any respect. In addition, the testimony of petitioner's representative, who prepared Mr. Barnum's New York income tax returns for the years at issue, also established that the IRS accepted petitioner's income and expenses as reported to the IRS, as detailed in Findings of Fact 2 and 10. This testimony also undermined the information, received from the IRS, which the Division relied upon in issuing the notices of deficiency in the first instance. Consequently, although petitioner was *required to maintain* adequate records of his income and deductions for the years in issue from his activities as a musician (Tax Law § 658[a]; 20 NYCRR 158.1[a][3]), such failure does not automatically mandate the denial of his petition in light of the above. In short, the New York income tax returns presented at hearing, which show tax due, as corrected for errors in subtraction as detailed in Finding of Fact 2, of $1,346.00 for 2000, a refund of $11.00 for 2001 and tax due of $3,138.00 for 2002 are accepted as accurately showing tax due for 2000 and 2002 and a small refund for 2001.

D. Addressing the procedural issues raised by petitioner, it is concluded that the documents introduced by the Division of Taxation in support of its case were properly marked into evidence pursuant to State Administrative Procedure Act § 306(2), which provides as follows:

> All evidence, including records and documents in the possession of the agency of which it desires to avail itself, shall be offered and made a part of the record, and

[3] This regulation provides as follows:
"Every person subject to New York State income tax . . . must keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits and other matters required to be shown by such person in any New York State income tax return . . . ."

> all such documentary evidence may be received in the form of copies or excerpts, or by incorporation by reference.

E. Petitioner is correct that the auditor's affidavit was not specifically itemized on the Division's hearing memorandum. Pursuant to 20 NYCRR 3000.14(b)(2), the Division was required to include "a list of all exhibits to be introduced at hearing," and the auditor's affidavit was not so listed. However, in light of the conclusion that petitioner has established the validity of the New York State and City personal income tax returns presented at the hearing by his credible testimony, including his proof that the IRS accepted his reported income and expenses for the years at issue, the issue whether the administrative law judge should have precluded the introduction into evidence of the auditor's affidavit is moot. Nonetheless, it is observed that there is nothing in the record to support a finding that the Division failed to make "a good faith effort" to comply with the requirements of 20 NYCRR 3000.14 so as to preclude the introduction into evidence of the auditor's affidavit.

F. Finally, it is concluded that petitioner has not established reasonable cause for the abatement of penalties (***see CBS Corp. v Tax Appeals Tribunal***, ___ AD3d ___, 867 NY52d 270 [the court reaffirmed the stiff standard imposed upon a taxpayer to establish that its failure to pay tax was due to reasonable cause and not willful neglect emphasizing that 'willfulness does not require an intent to deprive the government of its money but only something more than accidental nonpayment' (***Matter of Auerbach v. State Tax Commn.***, 142 AD2d at 395)"]). Even though the reason for petitioner's nonpayment of tax was the result of his depression after the death of a loved one and evokes sympathy, such failure to pay tax was nonetheless something more than "accidental nonpayment."

G. The petition of Donald C. Barnum, Jr. is granted to the extent indicated in Conclusion of Law C; the notices of deficiency dated March 5, 2007 with reference to 2000 and 2002 are to

be modified to so conform, and the notice of deficiency dated March 5, 2007 with reference to 2001 is canceled and a refund of $11.00 plus interest is granted, but, in all other respects, the petition is denied.

DATED: Troy, New York
January 29, 2009

/s/ Frank W. Barrie
ADMINISTRATIVE LAW JUDGE